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SUBJECT: KNEE JERK REACTIONS EXACERBATING LATVIA'S PROBLEMS

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Classified By: Ambassador Charles W. Larson, Jr. Reason: 1.4 (d)

11. (C/NF) Summary: The failure of the Latvian government to engage the people in the realities of the economic situation and to explain what will be needed to move the country forward has sent trust in government to historic lows. This tension boiled over into violence following an anti-government rally on January 13, something unheard of in Latvia. Political discourse in Latvia has been reduced to a series of knee jerk reactions characterized by a flurry of finger pointing and denunciations. President Zatlers entered the fray by announcing that he will propose a dissolution of parliament if legislators do not pass certain legislation by March 31. Zatlers' populist proposals could actually make the situation worse. Additionally, the government's calm face on implementation of the austerity measures covers up a haphazard process in which government agencies are operating on weekly budget allotments, unable to do any kind of planning. If Latvia continues to suffer knee jerk political and economic solutions to its growing problems, the situation could get much worse. There are no simple solutions and, unfortunately, it may take going to the brink of total collapse to bring some sense to the process. The problem with going to the brink is that it does not take much to go over. End summary.

12. (C/NF) The first few weeks of 2009 in Latvia have been full of bad news resulting from the implementation of the fiscal austerity package adopted at the end of 2008 (ref b). Latvians are paying more with increased VAT, while also seeing the value of their homes drop, and learning of cuts in social services. Government employees are beginning to learn of the cuts in pay or losses of jobs that are coming (ref c) while private sector employees are bracing for similar pain and layoffs. Latvia's leaders have not attempted to engage the public meaningfully and explain what is happening and what is to come. The President and Prime Minister have spoken on television but neither has gone out to meet with people, hear their concerns, and attempt to explain the way forward. PM Godmanis made an analogy to how penguins huddle together for warmth as a way to appeal for national unity but his remarks instead became a symbol of the government being out of touch.

13. (C/NF) Other government actions have exacerbated the problem. The Finance Minister gave an interview to Bloomberg TV in which he demonstrated a lack of knowledge of finance and limited English skills. The interview became a running joke as well as spurred genuine concern that he was not up to negotiating with the IMF and other donors. Then came evidence that politicians were continuing in their usual ways, notably the December 30 "hidden" signing of a \$12 million contract for construction of a new concert hall long associated with the People's Party and the news that the son of Transport Minister's Slesers' chauffeur had been given a high level job within the ministry at eight times the average monthly salary. Recent polls show less than ten percent of

people have confidence in Saeima and only a few more trust the government.

14. (C/NF) It was inevitable that people would turn their economic frustration to political protest. On January 13, roughly 10,000 people gathered in the center of Riga's old city to protest. But the event brought together over 30 groups with disparate goals. While the main organizers, the party Society for Different Politics (SCP), wanted a dismissal of Saeima, others only wanted changes in government. Those who came frustrated by economic decline and political stagnation left with no clear idea of what should happen next. Unfortunately, some of them turned to violence, something unheard of in Latvian politics (ref e). The next day, most people seemed to blame the government and its lack of response to the people's concerns for the violence.

15. (C/NF) President Zatlers joined the fray on January 14 by announcing three tasks for parliament and three tasks for government. He said that if Saeima did not complete its tasks - amending the constitution to allow the public to initiate a dismissal of Saeima, reforming the electoral law, and creating an oversight board for the international financial assistance - by March 31, he would initiate a dissolution of parliament. The three tasks for government - develop a clear plan for government restructuring in 2-3 weeks, bring new faces into government, perhaps with an expanded government of national unity, and choose a new head for the anti-corruption agency - do not come with a timeline as the president has no authority to dismiss the government. Many average Latvians applauded the President's strong

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stance, although most said he should not wait until March, but dismiss the Saeima immediately. Editorial opinion has been more nuanced, with the leading Latvian language paper saying he seems to be rewarding violence and cautioning that the all or nothing approach could lead to nothing. The leading Russian daily lamented that Zatlers "only came to the stage once the others had left it."

16. (C/NF) The President's proposals are problematic and appear to us to be an immediate reaction to the events of the 13th rather than a considered plan. The constitutional amendments are complicated and have real consequences for the balance of power in Latvia (ref a). Public debate on the issue has largely been superficial and no one has really tried to explain the consequences. His proposed electoral reforms would actually strengthen the role of the parties, which in our view is the wrong direction to go. The public wants more accountability from Saeima. A much better reform would be to introduce single member districts for at least half the seats in parliament. These are fundamental issues about how Latvians want to govern themselves and they need more debate than either the President's rushed schedule or the silence that the coalition has imposed to date provides.

Similarly, his demand for a wider coalition is unlikely to satisfy a public that wants change, not more of the same, just with some "new faces." Most importantly, the President does not appear to have spoken directly to any of the parties in the 24 hours since making his announcement. In a parliamentary system, that is not a tactic for ensuring legislative success.

17. (C/NF) Many Latvians believe that dissolving the Saeima is the solution to their problems. The President seems inclined to agree. However, the constitutional and practical aspects of the process mean that a dissolution shortly after March 31 would not yield a new parliament until September and a new government could take longer to form. The resulting period of political uncertainty throughout this process would also have consequences for the confidence of financial markets in Latvia, which is already low. Meanwhile, Latvia has a number of politically difficult commitments to meet under its agreement with the IMF, most notably comprehensive reform of

the education and health care system. The current government was already going to delay these until after June parliamentary elections (ref d) and no one would take these on in the run-up to national elections.

18. (C/NF) To make matters more challenging, the same kinds of knee jerk reactions we see in politics are happening in the economic field. Since passing the fiscal austerity package in December, the government has mandated a number of across the board cuts for ministries and government services and ordered that 10% of the budget be held in reserve. So far, however, no political guidance on spending priorities has been provided and many ministries are forced to work week to week, with no ability to plan more than a few days ahead. People do not know if they will have a job in a few days and ministries have taken to issuing public warnings of their situations - the border guard says it will lack fuel for its vehicles after July and the passport agency says it will be unable to issue travel documents after September. We also understand that agencies can successfully appeal to the PM for additional resources or release of their reserve, but this is being done with no coordination or strategic plan about how to use the budget or what the state's overall priorities should be. We hope that establishment of a fulltime IMF presence here will help bring some discipline and oversight to the process, but that will take time.

19. (C/NF) Probably the best solution for Latvia in the coming months would be some sort of government of national unity, headed by a non-political Prime Minister and staffed largely by technocratic ministers. This would allow the swiftest implementation of the needed economic reforms and have all parties share equally in the pain, while avoiding the cost and distraction of a national political campaign. But this is highly unlikely to occur. The politicians, even some in opposition, will not willingly surrender their authority for such a plan and, of course, many personal financial interests will be threatened. Finding people willing to serve will be tough. The public will not find their pain lessened and will continue to agitate for relief. It is likely that the country will have to go to the brink of collapse - more rallies with violence, an inability to defend the currency, failure to meet the terms of the IMF agreement - before there could be agreement on such a move. The problem with going to the brink, though, is that once you get to the edge, it becomes very easy to go over.

LARSON